AP Macroeconomics
Test: What Is Economics?
Instructor's Version

Answers: Free-Response Questions

1. Economics

A. Explain the effect(s) of scarcity on societies. (3 points)

Answer: Because of scarcity, societies develop economic rules and institutions to choose what wants to satisfy. This leads different societies to distribute goods and services differently.

2 points for the first sentence; 1 point for the second sentence.

B. What are the three principal types of economies? (3 points)

Answer: Traditional, Market, Command

1 point for each.

C. Describe how a free-market system answers the three fundamental questions of economics. (6 points)

Answer: The market answers the question, "What goods and services will be produced?" Producers answer the question, "How will those goods and services be produced?" Whoever can and will pay determines the answer to the question, "Who will get those goods and services?"

1 point for correctly stating each question; 1 point for identifying the way each is answered.

D. Define *efficiency* and explain how it is achieved. (4 points)

Answer: Efficiency occurs when no resources are being wasted. Efficiency is achieved when a reallocation of resources among producers will not lead to an increase in their combined output.

2 points for each sentence.

E. Describe profit and explain how it is calculated. (4 points)

Answer: Profit is the difference between the price a seller receives and the cost a seller pays. Profit is calculated by subtracting the total cost of resources used in production from the total revenue received from sales.

2 points for each sentence.

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F. Explain how economists define a market. (2 points)

Answer: A market is a place where buyers and sellers exchange goods or services for a price they agree on.

1 point for mentioning exchange between buyers and sellers; 1 point for mentioning agreed upon price.

G. Describe the difference between microeconomics and macroeconomics. (2 points)

Answer: Microeconomics focuses on individual behavior. Macroeconomics focuses on the behavior of the economy as a whole.

1 point for each sentence.

2. The Free-Market System

A. Describe the role price plays in a free-market system. (3 points)

Answer: Prices are a medium to exchange goods and services in free markets. Price indicates the value that buyers and sellers place on goods and services.

Either sentence is worth 3 points.

B. Summarize Adam Smith's argument for the free market. (6 points)

Answer: In a free-market economy, the government stays out of the economy. This enables producers and consumers to do as they wish. They will act in self-interest and create the greatest benefit for all.

2 points for each sentence.

3. The Circular Flow

A. Describe the circular flow of economic activity. (4 points)

Answer: Resource owners sell their resources to business owners in the factor market. In exchange they get rent, wages, or interest. The business owners then use the resources they buy to make goods or services. Finally, they sell these goods and services in the product market, to the resource owners.

1 point for each sentence.

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B. Describe the product market. (4 points)

Answer: The product market is where goods and services are exchanged for a selling price.

3 points for mentioning exchange of goods and services; 1 point for mentioning selling price.

C. Describe the factor market, and list the three things sellers receive in this market. (4 points)

Answer: The factor market is where resources and semifinished products are exchanged. Landlords receive rent for land. Workers receive wages for labor. Investors receive interest for capital.

1 point for each sentence.

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